INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	9
Summary of argument	9
Argument:	
I. Atlas was not a party to the reorganization within the literal terms of the statutory definition	12
II. Atlas was not a party to the statutory reorganization because it conceived and executed a general plan which included such a reorganization	23
Conclusion	36
Appendix	37

CITATIONS

Cases:

Ahles Realty Corp. v. *Commissioner*, 71 F. (2d) 150, certiorari denied, 293 U. S. 611 — 20

Bassick v. *Commissioner*, 85 F. (2d) 8, certiorari denied, 299 U. S. 592 — 20

Bowers v. *Lawyers Mortgage Co.*, 285 U. S. 182 — 35

Burnet v. *Commonwealth Improvement Co.*, 287 U. S. 415 — 21

Burnet v. *Houston*, 283 U. S. 223 — 12, 19, 35

Bus & Transport Corp. v. *Helvering*, 296 U. S. 391 — 11, 26, 27, 28, 29, 30

Commissioner v. *Groman*, 86 F. (2d) 670, pending on certiorari, No. 21, October Term, 1937 — 19, 24, 31, 32

Cortland Specialty Co. v. *Commissioner*, 60 F. (2d) 937 — 30

Dalton v. *Bowers*, 287 U. S. 404 — 20

Fifth Avenue Bank v. *Commissioner*, 31 B. T. A. 945, affirmed, 84 F. (2d) 787 — 8, 24, 33

First National Bank of Champlain v. *Commissioner*, 21 B. T. A. 415 — 34

G. & K. Mfg. Co. v. *Helvering*, 296 U. S. 389 — 13

Helvering v. *Minnesota Tea Co.*, 296 U. S. 378 — 9, 13, 17, 30, 35

Helvering v. *Morgan's*, 293 U. S. 121 — 21

Helvering v. *Tex-Penn Oil Co.*, 300 U. S. 481 — 19

7656—37——1

Cases—Continued. Page

Helvering v. *Watts*, 296 U. S. 387 ..... 13, 30
Nelson Co. v. *Helvering*, 296 U. S. 374 ..... 13, 30
New Colonial Co. v. *Helvering*, 292 U. S. 435 ..... 12, 35
Pinellas Ice Co. v. *Commissioner*, 287 U. S. 462 30
Rogers v. *Strong*, 72 F. (2d) 455, certiorari denied, 293 U. S. 621 22
Starr v. *Commissioner*, 82 F. (2d) 964, certiorari denied, 298 U. S. 680 20
Tulsa Oxygen Co. v. *Commissioner*, 18 B. T. A. 1283 ..... 24, 34
Union Trust Co. v. *Heiner* (W. D. Pa.), decided February 24, 1937, 1937 Prentice-Hall, Vol. 1, par. 1218 21
United States v. *Phellis*, 257 U. S. 156 25
Weiss v. *Stearn*, 265 U. S. 242 25
Woolford Realty Co. v. *Rose*, 286 U. S. 319 21

Statutes:

Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 203 (b) (2) .. 15
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 112 37
Revenue Act of 1934, c. 277, 48 Stat. 680:
Sec. 112 (g) (1) (U. S. C., Title 26, Sec. 112) 16
Sec. 112 (g) (2) (U. S. C., Title 26, Sec. 112) 16

Miscellaneous:

H. Rep. No. 179, 68th Cong., 1st Sess., p. 16 15
S. Rep. No. 398, 68th Cong., 1st Sess., p. 17 16
Treasury Regulations 74:
Art. 577 39

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 33.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

RAYMOND I. BASHFORD

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 137–143) is reported in 33 B. T. A. 10. The opinion of the Circuit Court of Appeals (R. 202–206) is reported in 87 F. (2d) 827.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 22, 1937 (R. 206). The petition for writ of certiorari was filed April 22, 1937, and was granted May 24, 1937 (R. 208). The jurisdiction of this Court rests on Section 240 (*a*) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Taxpayer owned stock in A corporation, which transferred its assets to B corporation in a statutory reorganization. Taxpayer exchanged his stock in A corporation for stock in B corporation, cash, and stock in C corporation. C corporation is the parent of B and the instigator of the reorganigation plan. The question is whether the gain represented by the C stock is taxable. This depends upon whether the C stock is stock of a corportion a party to the reorganization, under Section 112 (b) (3), or "other property" under Section 112 (c) (1), Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra,* pp. 37–41.

STATEMENT

The facts in this case, except those disclosed by the testimony of two witnesses, were stipulated before the Board of Tax Appeals (R. 19–56). Attached to the stipulation as exhibits (R. 57–126) are the several documents and agreements referred to herein. Separate findings of fact were not made by the Board. Its findings of fact were included in its opinion (R. 127–143), and may be summarized as follows:

On and prior to October 7, 1930, the Peerless Explosives Company, a Delaware corporation, herein called Peerless, was engaged in the manufacture

and sale of explosives. Its stock issued and outstanding on that date consisted of 17,672 shares of preferred stock of a par value of $25 per share and 14,890 shares of common stock of no par value. Bashford, the taxpayer herein, was the owner of 2,541 shares of its common and 28 shares of its preferred stock. (R. 19, 26, 128.)

On and prior to October 7, 1930, the Union Explosives Company, a West Virginia corporation, herein called Union, was engaged in the manufacture and sale of explosives. It had outstanding 3,367½ shares of preferred stock of a par value of $100 per share and 4,044 shares of common of no par value. (R. 19, 128.)

On and prior to October 7, 1930, the Black Diamond Powder Company, a Pennsylvania corporation, herein called Black Diamond, was engaged in the powder business. It had outstanding 1,584 shares of common stock of the par value of $100 per share, all of which was owned by Peerless. (R. 20, 128.)

Peerless, Union and Black Diamond were all purchasers from and competitors of the Atlas Powder Company, herein called Atlas, a Delaware corporation which had issued and outstanding 261,438¾ shares of common stock of no par value, including treasury stock, and 96,318 shares of preferred stock of $100 par value (R. 21, 128–129). Atlas was not satisfied with its position of rivalry with the other three corporations and desired to

remove the competition and acquire the business of Peerless, Union and Black Diamond. Early in 1930, its president conceived the plan of attaining this end by means of reorganizing the three competitive companies into a new corporation to be controlled by Atlas. In order that its identity would not be apparent, the early negotiations to carry out this plan were made on behalf of Atlas by individual agents. (R. 129–130.) The identity of Atlas was not disclosed until the agents had secured from the majority stockholders of Peerless and Union their oral assurrances that they would exchange their stock under the plan proposed (R. 130). It was stressed by the agents in dealing with the stockholders that a strong financial interest was represented and would participate in the plan by furnishing funds, and that the two agents of Atlas and the principal stockholders of Peerless and Union would be officers in the new company (R. 130).

The main features of the reorganization plan were that Peerless, Union and Black Diamond were to be consolidated into Peerless-Union Explosives Corporation, herein called the new company, that the holders of stock of the old companies would receive for their stock cash, Atlas stock and stock in the new company, and that Atlas would furnish the new company with sufficient cash and Atlas stock to complete the transaction in exchange for controlling amounts of the new company's common and preferred stock (R. 130–131).

On September 22, 1930, Atlas caused the new corporation to be incorporated under the laws of Delaware for the purpose of acquiring the business and assets of Peerless, Union and Black Diamond. Atlas subscribed to all of the original issue of stock of the new company, 10 shares of common and 10 of preferred, all of which was issued to Atlas. Later the authorized capital stock of the new company was increased to 100,000 shares of common of no par value and 50,000 shares of preferred of $100 par value, of which there would be outstanding 21,732 shares of preferred and 65,000 shares of common (R. 131, 132). On October 2, 1930, the board of directors of Atlas approved the proposed reorganization and the incorporation of the new company and authorized its officers to invest in the capital stock of the new company up to an aggregate of 21,732 shares of the preferred stock of the new company and 32,198 shares of its common stock. In consideration therefor Atlas was to deliver to the new company $960,560.25 in cash, 6,318 shares of Atlas preferred stock on the basis of $100 per share, and 8,712½ shares of Atlas common stock on the basis of $66.66⅔ per share (R. 131–132).

On October 7, 1930, the majority stockholders of Peerless and Union, including the taxpayer, entered into written contracts with the agents of Atlas to deliver their shares of stock in their respective corporations to the agents, who were acting as promoters of the new company, in exchange

for cash, shares of common stock of the new company and shares of common and preferred stock of Atlas in agreed amounts. Certain warranties and agreements as to carrying out the reorganization were made by the agents. (R. 49–83, 132–135.) On the same day, October 7, 1930, the agents of Atlas and the new company contracted in writing that the agents would exchange for cash, stock in Atlas and stock in the new company the stock in the old companies which they had obtained. There were further agreements relative to the employment of stockholders of the old companies by the new, to the dissolution of the old companies and the acquisition of their assets and the assumption of their liabilities, and to the reimbursement of stockholders for any income tax imposed upon them growing out of the transaction. (R. 83–88, 135.) Atlas' agents also secured options on practically all the minority stockholdings in Peerless and Union (R. 135–136).

On October 7, 1930, the transfers and exchanges were made pursuant to the agreements and reorganization plan. The assets of Peerless, Black Diamond and Union were transferred to the new company, and the old companies were dissolved. The result was that the new company was the owner of practically all the stock and all the assets of the old companies. Atlas was the owner of all the preferred stock and over 57% of the common stock of the new company. (R. 135–136.)

The taxpayer was one of the majority stockholders of Peerless. His part in the plan was the exchange of his stock in Peerless for cash, stock in the new company and Atlas stock. (R. 132–133.) The Commissioner of Internal Revenue assessed a deficiency against him (R. 12–15) upon the theory that there had been a statutory reorganization effected between the three old companies and the new company, as the latter had acquired all the stock and assets of the former, but that, as to Atlas, it was not a party to such reorganization, and, therefore, its common and preferred stock received in exchange by the taxpayer was to be treated as "other property" in the statutory reorganization and the gain thereupon was to be recognized along with the cash received, under the provisions of Section 112 (c) (1), Revenue Act of 1928, *infra*, p. 37.

Before the Board, the Commissioner changed his position and claimed, in addition, that no statutory reorganization was effected, but that the entire transaction constituted a sale, and that the gain upon both the stock of the new company and Atlas Powder Company should be recognized (R. 139).

The Board of Tax Appeals sustained the contentions of the taxpayer and held, first, that there had been a statutory reorganization effected between the three old companies and the new corporation and, second, that the Atlas Powder Company was a party thereto by reason of its initiation

of and intimate connection with the plan. Consequently, the gain upon the Atlas stock was held to be unrecognized under Section 112 (b) (3), *infra*, p. 37. This decision of the Board was based upon its former decision in *Fifth Avenue Bank of New York* v. *Commissioner*, 31 B. T. A. 945, affirmed by the Circuit Court of Appeals for the Third Circuit, June 16, 1936, 84 F. (2d) 787. (R. 141–142.)

In the Circuit Court of Appeals the Commissioner conceded that a statutory reorganization had been effected between the new corporation and the three smaller companies by reason of the acquisition by the former of practically all the stock and all of the assets of the latter. The Commissioner contended, however, that Atlas was not a party to the reorganization within the statutory definition of that term, and that the intimate connection of Atlas with the reorganization and the participation of its subsidiary did not render Atlas a party. (R. 204.)

The court held Atlas was a party to the reorganization within the literal terms of the statutory definition because Atlas had acquired a majority of the stock of all classes of the new company. The court further held Atlas a party to the reorganization, within the commonly understood meaning of that phrase, because of its intimate connection with the plan.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Atlas was a party to the reorganization effected by its subsidiary and three other corporations.

2. In holding that Atlas was a party to the reorganization, within the literal terms of the statutory definition, because it had acquired a majority of the stock of all classes of its subsidiary.

3. In holding that Atlas was a party to the reorganization effected by its subsidiary by reason of its intimate connection with such reorganization.

4. In failing to hold that Atlas was not a party to the reorganization effected by its subsidiary.

5. In failing to hold that the stock of Atlas received by the taxpayer did not represent a continuing interest in the same enterprise.

6. In failing to hold that the stock of Atlas received by the taxpayer represented "other property" on which gain is recognized under Section 112 (c) (1), Revenue Act of 1928.

7. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

There was a reorganization between Peerless, Union, Black Diamond, and the new company. *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378. But Atlas was not reorganized and, neither within the literal terms of the statutory definition nor within its purpose, was it a party to the reorganization.

I

The definition of "a party to a reorganization" is found in Section 112 (i) (2). It follows the definition of "reorganization" found in Section 112 (i) (1) and plainly must be read in connection with the definition of a reorganization. Atlas did not participate in the reorganization of Peerless, as defined in Section 112 (i) (1), and cannot, therefore, reasonably be said to have been a party to it. Section 112 (i) (2) includes a corporation which acquires "a majority of the voting stock and * * * all other classes of stock of another corporation." This plainly refers to the parenthetical explanation of merger or consolidation which is found in the definition of a reorganization and is not intended to bring into the definition of "a party to a reorganization" a corporation which was not reorganized.

We may assume that there was a reorganization between Atlas and the new company. But since the taxpayer was a stockholder of Peerless, the only question is whether Atlas was a party to the Peerless reorganization.

Atlas can be considered a party to this reorganization only if it be viewed as standing in the shoes of its subsidiary, the new company. Especially in the case of the reorganization provisions of the statute, which precisely define the degrees and types of corporate control, there is no warrant for looking through the separate corporate entities of Atlas and its subsidiary.

II

The court below also placed its decision upon the somewhat paradoxical ground that a corporation may be a party to the reorganization, although not reorganized itself, so long as it plays a sufficiently active role in the reorganization negotiations and financing. In this case Atlas took great pains to keep separate from the new company. If it deliberately cast itself in the role of a stranger to the reorganization, it hardly can claim a tax status based upon the proposition that it instigated the reorganization, or that as a matter of business practice it might just as well have absorbed the smaller corporations.

In *Bus & Transport Corp.* v. *Helvering,* 296 U. S. 391, this Court held that stock in a corporation which was a necessary step in the transfer of assets, and whose only asset was stock in a corporation which instigated the transaction, did not give the transferor the definite immediate interest in the corporation to which the assets were transferred. The principle of this decision seems necessarily to be that the transferor must have a direct stock ownership in the corporation to which the assets were transferred, and that, however important the part played by the instigator, its stock cannot be taken to be that of a party to the reorganization.

This principle is a necessary outgrowth of the established doctrine that the stock must represent a continuing and direct interest in the assets which

the transferee received. Plainly, stock in another corporation does not provide a definite and direct interest in the assets, even though the second corporation may own stock in the transferee.

We think it clear that the taxpayer has not been able to establish a right to the benefit of the statutory exemption. To obtain its benefits he must bring himself squarely within the language relied upon. *Burnet* v. *Houston,* 283 U. S. 223, 227; *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440. This the taxpayer has not done. It follows that the Atlas stock represents "other property" within the meaning of Section 112 (c) (1) and the gain realized on its receipt must be recognized.

ARGUMENT

I

ATLAS WAS NOT A PARTY TO THE REORGANIZATION WITHIN THE LITERAL TERMS OF THE STATUTORY DEFINITION

The taxpayer in this case, one of the majority stockholders in Peerless, exchanged his stock therein for stock of the new company, stock of Atlas and cash. The ultimate question for determination is whether the gain upon this exchange, to the extent represented by the Atlas stock, must be treated as having been received without recognition under the provisions of Section 112 (b) (3) of the Revenue Act of 1928, *infra,* p. 37, or whether it is subject to tax as gain upon "other property"

within the meaning of Section 112 (c) (1) of that Act. The correct determination of this question depends upon whether Atlas was a party to the statutory reorganization concededly effected between Peerless, Union, and Black Diamond on the one hand, and the new corporation on the other.

The decision of the court below that there was a reorganization between Peerless, Union, Black Diamond and the new company is in accordance with the rule laid down by this Court in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Helvering* v. *Watts*, 296 U. S. 387; *G. & K. Mfg. Co.* v. *Helvering*, 296 U. S. 389; and *Nelson Co.* v. *Helvering*, 296 U. S. 374. But Atlas was not a party to those exchanges between the old companies and the new company which did constitute a statutory reorganization, and acquired neither the assets nor any of the stock of the old companies. Instead the assets and stock of the old companies were acquired by Atlas' subsidiary, the new company, which was a separate and distinct corporate entity. We contend that it is manifest that one corporation is not a party to a reorganization, either within the literal language of the reorganization statute or its spirit, merely because another corporation, which it controls, is a party. The court below did not expressly hold that Atlas was a party to the reorganization because its subsidiary was a party, although this seems to be the necessary effect of its decision. It held, instead, that Atlas was a party to the reorganization because (1) it came within

the literal terms of the statutory definition[1] and (2) it was "the mainspring of the entire proceeding." The Board of Tax Appeals reached a similar conclusion because of the second ground alone. In this section we shall discuss the first ground relied upon by the court below.

1. Section 112 (i) (1) limits the term "reorganization" to five types of transactions: a merger, a consolidation, a transfer of assets to a corporation controlled by the transferor, a recapitalization, or a mere change in corporate identity. There is no contention that Peerless and Atlas bore any such relation to each other.

Immediately following this definition of "reorganization", Section 112 (i) (2) provides:

> The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

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[1] Respondent appears to be under the impression that this question is raised for the first time in our petition for certiorari (Br. in Opp. 8–9). Apart from the fact that this Court will consider the ground of decision (see Br. in Opp., 14) whether or not urged in the court below, it is perfectly plain that petitioner at every stage of this litigation has urged that Atlas was not a party to the reorganization (R. 141–142, 145, 147, 148–149, 204). It would be difficult to find a contention which more squarely raises the construction of the statutory definition of a "party to the reorganization".

This definition must, of course, be read with the definition of "reorganization". If there was no reorganization transaction between Peerless and Atlas, the latter cannot be a "party to the transaction" so far as the respondent, a stockholder of Peerless, is concerned.

It is true that Atlas acquired "a majority of the voting stock and * * * all other classes of stock of another corporation." But this corporation was Peerless-Union, the new company. It was not Peerless. Respondent would hardly contend that Atlas would be made a party to the Peerless reorganization merely because it had simultaneously acquired the majority of the stock of, say, the Pennsylvania Railroad Company. The clause in Section 112 (i) (2) relating to stock acquisition repeats the parenthetical explanation of merger or consolidation found in Section 112 (i) (1) (A) and is plainly designed only to insure that *both* corporations, in the case of a reorganization by stock acquisition, are considered parties to the reorganization. Thus, the House Ways and Means Committee explained the definition of a "party to a reorganization", when it first appeared, as Section 203 (h) (2) of the Revenue Act of 1924, as follows (H. Rep. No. 179, 68th Cong., 1st Sess., p. 16):

> (2) There is no provision of the existing law which corresponds to subdivision (h) (2) of the bill. This definition is inserted to remove any doubt as to whether a corpora-

> tion, all the stock of which is acquired in connection with the reorganization, is a party to the reorganization.

The Senate Committee on Finance used an identical explanation. S. Rep. No. 398, 68th Cong., 1st Sess., p. 17. It is evident that the legislative intent was confined to insuring that the corporation whose stock was acquired in a statutory reorganization would be considered a party.[2]

In this case Atlas acquired the majority of the stock of a corporation which itself was a part of the Peerless reorganization. This meant that respondent and Atlas were both stockholders of the new company. But since there was no reorganization between Peerless and Atlas, the fact that Atlas acquired a majority of the stock of the new company is wholly irrelevant to the question of whether Atlas was a party to the Peerless reorganization.

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[2] Similarly, when the definition of "reorganization" was changed in the Revenue Act of 1934 to limit clause (A) of Section 112 (g) (1) to a statutory merger or consolidation, and the case of acquisition of 80 per cent of the voting and other classes of stock put in a separate clause (B), a corresponding change in the definition of "a party to a reorganization" was made in Section 112 (g) (2), which provides:

"The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

It hardly would be contended that Atlas would come within the definition under the Act of 1934, yet the earlier Acts are equally plainly restricted to corporations which are reorganized or which themselves absorb reorganized corporations.

The purpose of the reorganization provisions of the Revenue Acts is to except from the general rule certain specifically described exchanges incident to such readjustment of corporate structures, which are made in one of the particular ways specified in their provisions, and which effect only a readjustment of continuing interests in property under modified corporate forms. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exceptions from the general rule.

Article 577, Treasury Regulations 74, *infra*, p. 39, promulgated thereunder, does not enlarge the statutory definition, but does point out that the definition is not all-inclusive and that it simply enumerates certain cases with respect to which doubt might arise. While it may be that the statutory definition and the regulations construing it are not all-inclusive, it is obvious that nothing in Article 577 purports to include as "a party to a reorganization" a corporation which did not enter into a reorganization with the corporation of which the taxpayer was a stockholder.

The taxpayer here cannot rely on a long continued administrative practice such as that which in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, was used in construing the statutory definition of a reorganization. In that case the regulations and

the practice of the Commissioner alike supported the view that clause (A) was not to be limited to transactions which were, or were similar to, technical mergers or consolidations. See 76 F. (2d) 797, 799, 800. Here the Regulations throw no light on the question and there are no rulings by the Bureau of Internal Revenue. So far as we can ascertain, the Commissioner has never treated a corporation as a party to the reorganization merely because it at that time acquired the majority of the stock of a corporation which was a party.

2. As there was more than one transfer involved in this case the transfers must be distinguished. It was the failure of the court below to distinguish the separate transactions which, we submit, led it into its erroneous decision that Atlas was a party to the Peerless reorganization.

The transaction whereby Atlas exchanged cash and its own preferred and common stock for a majority of all classes of stock of the new company may for present purposes be said to have constituted a statutory reorganization. The only way in which the court's conclusion that Atlas was a party to a reorganization, "within the literal terms of the statutory definition", can be reconciled with the undisputed facts in this case is to accept the view that the court had reference to the exchanges between Atlas and the new company. The language of the opinion itself indicates these were the exchanges which the court had in mind (R. 205).

But it is clear that Atlas was not a party, either in fact or within the language of the statute, to the exchanges between the new company and old companies which constituted the statutory reorganization out of which the present taxable transaction arose. *Commissioner* v. *Groman,* 86 F. (2d) 670 (C. C. A. 7th), pending in this Court, No. 21, October Term, 1937. Cf. *Bus & Trans. Corp.* v. *Helvering,* 296 U. S. 391. Respondent was a stockholder in Peerless, not Atlas, and the Atlas stock is recognized as gain unless Atlas was a party to the *Peerless* reorganization.

It is our contention that the transactions between the new company and Atlas on the one hand and between the new company and the old competing companies on the other were separate. It is true that the transactions were related, in the sense that probably neither would have been consummated had it not been for the other. But "that fact would not convert the two sales into one." *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481, 496. The agreement pursuant to which the Peerless assets and stock were transferred gave no rights to Atlas and imposed no duties on it save guaranteeing performance by the new company of some of its obligations (R. 91, 95, 100). Atlas was in no sense a party to the exchange of property and stock which constitued the Peerless reorganization.

It is to be noted that this contention that the transfers were separate does not ask that separate

steps in a plan of reorganization be viewed as independent transactions with legal consequences different from those which would result were the plan examined at its completion. See, *e. g., Bassick* v. *Commissioner,* 85 F. (2d) 8 (C. C. A. 2d), certiorari denied, 299 U. S. 592; *Ahles Realty Corp.* v. *Commissioner,* 71 F. (2d) 150 (C. C. A. 2d), certiorari denied, 293 U. S. 611; *Stark* v. *Commissioner,* 82 F. (2d) 964 (C. C. A. 4th), certiorari denied, 298 U. S. 680. At no stage in the transactions in this case was Atlas a party to the Peerless reorganization; at the completion as at the outset of these transactions its only relation to the Peerless reorganization was that its subsidiary, the new company, was a party.

3. The view of the court below seems in essence to be that Atlas comes within the statutory definition of a party to the reorganization because it owned a majority of the stock of the new company, which was concededly a party to the reorganization. But this view requires that the Court look through the corporate entities of Atlas and the new company and that it view them as identical, even though 43 per cent of the voting stock of the new companies was owned by persons other than Atlas (R. 136), and even though Atlas itself was insistent that the new company be separate and distinct (see *infra,* pp. 25–26). "Certainly, under the general rule for tax purposes a corporation is an entity distinct from its stockholders." *Dalton* v. *Bowers,*

287 U. S. 404, 410. See also *Burnet* v. *Commonwealth Improvement Co.*, 287 U. S. 415. Even where affiliated corporations file consolidated returns, they remain separate taxpayers. *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 328; *Helvering* v. *Morgan's Inc.*, 293 U. S. 121, 127. The necessity of maintaining the separate identity of parent and subsidiary is doubly apparent in the case of the reorganization provisions of the statute, where the degrees and types of corporate control and reorganization are defined with a meticulous precision.

A similar question was presented in *Union Trust Co.* v. *Heiner* (W. D. Pa.), decided February 24, 1937, not reported but found in 1937 Prentice-Hall, Vol. 1, par. 1218. The court there held that the parent was not a party to a reorganization in which the assets were transferred to a subsidiary. It accordingly held that stock of the parent, received by the transferors, must be taxed as realized gain.

If, as seems plainly to be the case, it is impossible to regard the parent as standing in the shoes of its reorganized affiliate, there is no warrant for the view that Atlas was a party to the reorganization under the statutory definition. Respondent retained an interest in the assets transferred from Peerless only because of his ownership of stock in the new company. Apart from the fact that Atlas owned stock in the new company, respondent's holding of Atlas stock represented no more of a

continuing interest in the Peerless assets than did the cash which he received.

4. Section 112 (c) (1), *infra*, provides that if an exchange would be nontaxable if it were not for the fact that the property received in exchange consists not only of property permitted by the reorganization sections to be received without the recognition of gain but of other property or cash, then the gain to the recipient should be recognized to the extent of the cash plus "the fair market value of such other property". Here, the taxpayer received in exchange for his stock (1) shares of the company to which his stock was transferred, (2) shares of Atlas, the parent company of the transferee, and (3) cash. The Atlas Company was not "a party to a reorganization", within the meaning of Section 112 (i) (2) of the Revenue Act of 1928, *infra*, since it acquired neither the stock nor the assets of Peerless, the taxpayer's corporation, but figured only as the instigator of the reorganization of the other companies. It is clear that what was done "was not aptly described by the words of the statute." *Rogers* v. *Strong*, 72 F. (2d) 455, 457, (C. C. A. 3d), certiorari denied, 293 U. S. 621. Hence, there was no literal compliance by Atlas with the language of either Section 112 (i) (1) or (i) (2) and, unless it may be deemed a party to the reorganization for reasons not based on the literal language of the statute, its shares constitute "other property" and must be treated as taxable income, along with the cash.

II

ATLAS WAS NOT A PARTY TO THE STATUTORY REORGANIZATION BECAUSE IT CONCEIVED AND EXECUTED A GENERAL PLAN WHICH INCLUDED SUCH A REORGANIZATION

It is also plain, we submit, that the court below was in error in holding that "one who is a party to a reorganization transaction as that language is commonly understood is a party within the meaning of the statute" and that "a corporation so intimately connected with the reorganization * * * is a party to the reorganization within the commonly understood meaning of that phrase, although not reorganized itself." (R. 205, 206.) This conclusion of the court is based upon the following facts: that Atlas conceived and executed, through its agents, the entire idea and plan whereby it obtained control, through the medium of a subsidiary corporation, of all the assets and properties of Peerless, Union, and Black Diamond; that Atlas furnished cash and enough of its own stock to accomplish the transaction; that Atlas was the "mainspring" of the entire proceeding, and without its participation there would have been no reorganization and consolidation into the new company (R. 205–206). These facts also form the basis of the Board's decision that "where the corporation is so intimately connected with the reorganization of other corporations that the reorganization depends upon its efforts or support, then such corporation is a party

to the reorganization although it is not reorganized itself" (R. 141–142).

1. These conclusions of the Board and the court below seem based upon the principle that a stranger to the actual reorganization may yet be a party to the reorganization if it plays a sufficiently active part in instigating and carrying out the plan.[3] The reasoning of the decision would seem probably to be applicable whether or not the new company was a subsidiary of Atlas. It would permit, for example, stockholders in corporations operating cotton mills to receive without recognition of gain stock in a mail order house which, for one reason or another, instigated a consolidation of the mills into a single concern. This, we submit, is a thoroughly unreasonable result and illustrates the difficulties inherent in the paradoxical position that a corporation may be a party to a reorganization although

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[3] The legislative history of the reorganization provisions throws no light upon the question as to whether a corporation may be considered a party to a reorganization merely because it plays an active role in instigating and financing the reorganization, except so far as it indicates that Congress had a quite different purpose in mind in enacting the definition of a "party to a reorganization." See pp. 15–16, *supra*.

We are informed that, although there have been no formal rulings, the Commissioner has consisently refused to allow such corporations to be treated as a party to the reorganization. See, for example, his position in *Tulsa Oxygen Co.* v. *Commissioner*, 18 B. T. A. 1283; *Fifth Avenue Bank* v. *Commissioner*, 31 B. T. A. 945, 84 F. (2d) 787 (C. C. A. 3rd); *Commissioner* v. *Groman*, 86 F. (2d) 670 (C. C. A. 7th), as well as in this case.

not itself reorganized (or absorbing a reorganized corporation).

It may be argued that, as a matter of business practice, it is immaterial whether Atlas chose to consolidate the old companies into a subsidiary of Atlas or to absorb them by a direct merger and that, in the latter case, respondent could have received Atlas stock without recognition of gain. Even if this were the case, tax law looks to "what was done, rather than the design and purpose of the participants." *United States* v. *Phellis,* 257 U. S. 156, 172; *Weiss* v. *Stearn,* 265 U. S. 242, 254. However, the facts of this case make it plain that there were important differences between direct absorption by Atlas of the old companies and their consolidation or merger into a subsidiary of Atlas.

The reorganization was part of a circuitous and involved scheme conceived and executed by Atlas for gaining control of the businesses of Peerless, Union and Black Diamond. The scheme involved the concealment from the stockholders of the smaller corporations of the identity of Atlas as the motivating financial interest which would ultimately control and direct the assets and affairs of the competing companies; to this end Atlas refrained from conducting direct negotiations with the smaller corporations or their stockholders (R. 129–131). Atlas desired neither to purchase the assets nor to acquire the stock of the smaller competing companies, nor did it desire to effect a merger, consolidation or reorganization as between

itself and them. The plan, as carried out, was to have a subsidiary of Atlas, organized for the purpose, acquire the stock and the assets of the competing corporation (R. 130). Atlas' entire interest in the transactions was carefully concealed, even to the extent of having it appear as a matter of record that Atlas was not a majority stockholder in the new company at the time of the stock transfers between the individual stockholders of the old companies and the two promoters, and between the promoters and the new company (R. 137–138). Whatever may have been the business advantages of keeping Atlas out of the reorganization, it is plain that Atlas and the parties considered them important and that Atlas meticulously refrained from entering the reorganization. Under such circumstances respondent hardly can claim a tax status based upon the proposition that Atlas might just as well have absorbed the smaller corporations directly.

2. The decision of the court below is in conflict with the principle applied by this Court in *Bus & Transport Corp.* v. *Helvering,* 296 U. S. 391.

In the *Bus & Transport Corp.* case, Jacobus, an individual, owned practically all the stock of two bus line corporations which will here be called A and B. Public Service [Corporation of New Jersey] desired to control A and B. Instead of directly acquiring the stock and assets of A and B, Public Service had its affiliated corporation, as agent, create a new corporation, herein called C.

Public Service's affiliate took all C's stock in exchange for 2500 shares of Public Service stock. Jacobus caused the organization of another new corporation, the taxpayer in that case, to which he transferred all his stock in A and B, acquiring all its stock in return. The taxpayer corporation then transferred the stock in A and B to Public Service's affiliate in exchange for the C stock. Thus the taxpayer corporation, through its ownership of the C stock it received in the exchange, indirectly controlled 2500 shares of Public Service stock.

The taxpayer corporation claimed that since it had exchanged property—*i. e.*, stock of A and B corporations—with Public Service's affiliate for stock of another corporation, C, which was a party to the plan, therefore the exchange constituted a reorganization and the stock of C was received without recognition of gain. There can be no doubt that C was a party to a part of the plan and to some of the exchanges carried out to effectuate the plan, yet this Court held (p. 393) that the receipt of the stock of the third corporation, C, which was not a direct party to the taxable exchange, did not give the taxpayer the "definite immediate interest" in Public Service's affiliate, the taxpayer's transferor, required by the statute to effectuate a reorganization. Accordingly, the Court stated that "Nothing here, we think even remotely resembles either merger or reorganization, as commonly

understood."[4] Standing alone, both the exchange whereby Jacobus acquired all the stock of the taxpayer in exchange for all the shares of A and B corporations, and the exchange whereby the affiliate of Public Service acquired all the stock of C in exchange for 2500 shares of Public Service stock, were, we believe, tax-free exchanges within the statutory definition of a reorganization. It follows that the basis of the decision in the *Bus & Trans. Corp.* case is that stock of a corporation other than one a party to the taxable exchange, even where such corporation is a vital part of the entire plan and intimately connected therewith, is insufficient to give to the recipient thereof the necessary definite immediate interest in the affairs of a corporation actually a party to the exchange, and hence that there is no reorganization. Applying this rule to the present case, it is clear, we submit, that Atlas, even though intimately connected with the plan and perhaps a party to other tax-free exchanges constituting a part of that plan, cannot qualify as a party to the exchange out of which the taxable transaction arose, because its stock represents only an indirect interest in and not a definite

[4] The court below used this statement to distinguish the *Bus & Transport Corp.* case (R. 206). But, plainly, if the relationship of the corporations were such as to prevent there being a reorganization, a similar relationship would prevent the instigating corporation from being a party to any reorganization which might exist with respect to other corporations.

immediate interest in the affairs of the new corporation.

It will be noted that C was just as intimately connected with the plan of the *Bus & Transport Corp.* case as was Atlas in the instant case. If stock of C did not afford the definite, immediate interest necessary to effect a statutory reorganization because it was not the corporation to whom the taxpayer transferred the property, manifestly, we think, a different result does not arise under the same language of the pertinent provisions because the third corporation is the parent of and owns an interest in one of the corporations "a party to the reorganization." The sole asset of C was stock in Public Service with which the party to the exchange was affiliated. It follows that, under the *Bus & Transport Corp.* case, the definite, immediate interest which is necessary if the transaction is to be a statutory reorganization, or a corporation a party thereto, cannot be found by tracing the inter-corporate relationships between the corporation the stock of which was exchanged and the corporation which was actually a party to the exchange.

3. The fundamental principle laid down by this Court in the construction and application of the reorganization provisions is that, for a party to an exchange to come within the exemption provisions, he or it must acquire an immediate, definite, and material interest in the assets and affairs of the other party; that this much is necessary in

order that the result accomplished may genuinely partake of the nature of merger or consolidation. *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378, 385; *Bus & Trans. Corp.* v. *Helvering, supra.* In the *Pinellas* case this Court approved the doctrine announced by the Circuit Court of Appeals for the Second Circuit in *Cortland Specialty Co.* v. *Commissioner,* 60 F. (2d) 937, 940, that the transactions described in the statute presuppose a continuance of interest on the part of the transferor in the properties transferred and that without this continuity of interest on the part of the transferor corporation or its stockholders there can be no exemption.

In the *Minnesota Tea* case, *supra,* this Court held that common stock of the transferee represented the definite and material interest in the affairs of the purchasing corporation required by the statute. *Nelson Co.* v. *Helvering,* 296 U. S. 374, 377, holds that preferred stock of a transferee corporation provides such an interest in its affairs. In *Helvering* v. *Watts,* 296 U. S. 387, 388, it was held that bonds of the transferor corporation, the payment of which was guaranteed by the transferee, also were securities within the definition and were not to be regarded as cash or short-term notes. But, in *Bus & Trans. Corp.* v. *Helvering, supra,* decided at the same time, this Court held that stock of a corporation not a party to the exchange did

not represent any definite, immediate interest in the affairs of the transferee and accordingly concluded that the exchange did not even remotely resemble a merger or reorganization. We submit that the principle announced by this Court in the *Pinellas* and *Minnesota Tea Co.* cases, and recognized and applied in the *Bus & Transport Corp.* case, compels the conclusion in the instant case that the stock of Atlas does not provide the continuity of interest in the affairs of the new corporation necessary to bring it within the exemption provisions, even though Atlas is unquestionably financially interested and intimately connected with the reorganization.

The Court of Appeals for the Seventh Circuit appears to be the only other court which has passed directly upon the precise question presented here. *Commissioner* v. *Groman,* 86 F. (2d) 670, now pending in this Court on writ of certiorari, No. 21, October Term, 1937, involves circumstances substantially identical with those in the instant case. The taxpayer there was a stockholder in the Metals Refining Company of Indiana, herein called Indiana. In January, 1929, The Glidden Company, an Ohio corporation, entered into an agreement with the stockholders of Indiana whereby all the stock of Indiana was to be transferred to a third company, Metals Refining Company of Ohio, herein called Ohio, which was to be formed by The Glidden Company. The consideration was to be cash,

preferred stock of Ohio, and preferred stock of Glidden, the parent company. Ohio was organized by Glidden, which paid cash for all of its common stock. Glidden received none of the preferred stock of Ohio. The exchanges were carried out as agreed. Ohio then acquired the assets and properties of Indiana, which was then dissolved. Each of Indiana's stockholders, including the taxpayer, received a proportionate amount of the cash, Ohio stock and Glidden stock. The Circuit Court of Appeals for the Seventh Circuit rejected arguments similar to those adopted by the court below and held that a parent company was not, within the meaning of the statutory definition, a party to a reorganization to which its subsidiary was a party, and hence that the receipt by the taxpayer of the Glidden stock was taxable. The court said (86 F. (2d) 670, 672):

> We see no reason for extending the meaning of the term "party" as it appears in section 112 (i) (2) (26 U. S. C. A. § 112 (g) (2) note). To hold otherwise would be to usurp legislative functions. Congress has defined a party to a reorganization so as to permit a taxpayer to avoid what would otherwise be taxable income. It could have refused to allow such deductions altogether. Having exempted "gains" through reorganization, it could and did define reorganizations. In so doing it used the term "a party" referring to those who were in the reorganization. We must hold respondent

> to the definition which Congress specifically gave to the word "party". It would, we think, be a forced construction to assume that under such circumstances there were parties other than those defined by the statute. Respondent relies upon the exemption of the statute, but declines to abide by the Congressional definition of essential terms.
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> Our conclusion, however, is based not upon the reasons for Congressional action, but upon the fact that Congress, in exempting gains derived through the transfer of stock which transfers are but a part of reorganizations, saw fit to define with particularity the terms "reorganization" and "parties to reorganization". As we apply these definitions to the facts before us, we are impelled to the conclusion that the Glidden preferred stock was not exempted.

The court below in *Commissioner* v. *Fifth Avenue Bank*, 84 F. (2d) 787, dealt with a similar question. There the taxpayer agreed by contract with Cyanamid to transfer his stock in Antitoxin to Cyanamid or a new corporation in exchange for non-voting common stock of Cyanamid and preferred stock of the new corporation. On the same day a wholly owned subsidiary of Cyanamid agreed to purchase the Cyanamid stock received by the taxpayer at $31 per share. The other stockholders of Antitoxin made a similar agreement and the transfers were carried out. The Board (31 B. T.

A. 945) and the court below held that this was a reorganization and that Cyanamid was a party, with the result that its stock was received without recognition of gain. It will be noted that the basic agreements were made with Cyanamid and that it could call for delivery of the Antitoxin stock to itself. Apart from the fact that no contention could be made that Cyanamid came within the literal statutory definition, since it owned none of the preferred stock of the new corporation, Cyanamid was thus rather closer to being an actual party to the reorganization than is Atlas in this case. But it must be admitted that the reasoning of the Board (31 B. T. A. at 950–952), adopted by the court with some hesitation (p. 789), would cover the present transaction as well.[5] For the reasons which we have indicated, it seems to us that the *Groman* case is the better reasoned, and that the rule of the Circuit Court of Appeals for the Third Circuit cannot be squared with the words or the purpose of the statute.

4. While this Court has recognized that the liberal purpose of the reorganization provisions is to encourage and not to penalize reorganizations and readjustment of corporate structures, it has at the

[5] The Board in two other decisions has adopted reasoning more or less similar to that of the Board and the court below in this case. *Tulsa Oxygen Co.* v. *Commissioner*, 18 B. T. A. 1283; *First National Bank of Champlain* v. *Commissioner*, 21 B. T. A. 415.

same time construed and applied these provisions strictly in accordance with the literal language of the provisions themselves. *Helvering* v. *Minnesota Tea Co., supra.* Such a rule is, of course, in accord with the well established principle that one claiming the benefit of an exemption or deductions from tax must bring himself squarely within the language relied upon. *Burnet* v. *Houston,* 283 U. S. 223, 227; *Bowers* v. *Lawyers Mortgage Co.,* 285 U. S. 182, 187. The taxpayer "must be able to point to an applicable statute and show that he comes within its terms." *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440.

A corporation in the position of Atlas is included in neither the statutory definition of "reorganization" nor in that of a "party to a reorganization." The view that its stock can qualify for the exemption granted under those provisions merely because Atlas controlled, through stock ownership, a corporation whose stock did qualify, or because it played a leading role in the instigation and completion of the reorganization, is an unwarranted extension of the statute. It follows that since Atlas is not "a party to the reorganization", the gain upon its stock is not granted exemption from recognition under Section 112 (b) (3), *infra,* but must be recognized as gain upon "other property", within the meaning of Section 112 (c) (1), *infra.*

CONCLUSION

In view of the foregoing, the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other prop-

erty or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section, the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 577. *Definitions.*—The term "reorganization" as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least

a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immeditately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation within the meaning of section 112, when owning—

(1) At least 80 per cent of the voting stock, and

(2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if

"stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

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